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ABSTRACT

This report is comprised of two separate papers, "A Tax Credit for Certain Educational Expenses" by James A. Maxwell and Bernard L. Weinstein and "Income Tax Credits for Tuitions and Gifts in Nonpublic School Education" by Roger A. Freeman. The first paper is based on the assumption that provision of financial relief to parents who send their children to nonpublic schools would improve horizontal equity and be good public policy. The tax credit, as a method that appears to have promise, is discussed as to the history of tax credits, their justification for educational expenses, the design of the tax credit, its economic impact, administrative problems, constitutional problems, and treasury objectives. Two appendixes to the report present: State Experience with Tax Credits, and Estimated Costs of Tax Credit Proposals. The second paper discusses the ways in which nonpublic school education can be aided by the national government. These ways are delineated under the following sections: Tax Benefits: Exclusions, Exemptions, Deducations, Credits; What Are Deductions For?; Do Tuitions ualify under Our System of Tax Deductions?; Objections to Tuition Tax Credits; and A Tax Credit Plan. (For related document, see ED 058 473.) (DB)

Tax Credits for Education

Submitted to The President's Commission on School Finance

THIS IS ONE OF SEVERAL REPORTS PREPARED FOR THIS COMMISSION. TO AID IN OUR DELIBERATIONS, WE HAVE SOUGHT THE BEST QUALIFIED PEOPLE AND INSTITUTIONS TO CONDUCT THE MANY STUDY PROJECTS RELATING TO OUR BROAD MANDATE. COMMISSION STAFF MEMBERS HAVE ALSO PREPARED CERTAIN REPORTS.

WE ARE PUBLISHING THEM ALL SO THAT OTHERS MAY HAVE ACCESS TO THE SAME COMPREHENSIVE ANALYSIS OF THESE SUBJECTS THAT THE COMMISSION SOUGHT TO OBTAIN. IN OUR OWN FINAL REPORT WE WILL NOT BE ABLE TO ADDRESS IN DETAIL EVERY ASPECT OF EACH AREA STUDIED. BUT THOSE WHO SEEK ADDITIONAL INSIGHTS INTO THE COMPLEX PROBLEMS OF EDUCATION IN GENERAL AND SCHOOL FINANCE IN PARTICULAR WILL FIND MUCH CONTAINED IN THESE PROJECT REPORTS.

WE HAVE FOUND MUCH OF VALUE IN THEM FOR OUR OWN DELIBERATIONS. THE FACT THAT WE ARE NOW PUBLISHING THEM, HOWEVER, SHOULD IN NO SENSE BE VIEWED AS ENDORSEMENT OF ANY OR ALL OF THEIR FINDINGS AND CONCLUSIONS. THE COMMISSION HAS REVIEWED THIS REPORT AND THE OTHERS BUT HAS DRAWN ITS OWN CONCLUSIONS AND WILL OFFER ITS OWN RECOMMENDATIONS. THE FINAL REPORT OF THE COMMISSION MAY WELL BE AT VARIANCE WITH OR IN OPPOSITION TO VIEWS AND RECOMMENDATIONS CONTAINED IN THIS AND OTHER PROJECT REPORTS.

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TAX CREDITS FOR EDUCATION

Two Papers Submitted to the

President's Commission on School Finance in

October 1971 and December 1971

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A TAX CREDIT FOR CERTAIN

EDUCATIONAL EXPENSES

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October 1971

A TAX CREDIT FOR CERTAIN EDUCATIONAL EXPENSES

In what follows, the implicit assumption is that provision of financial relief to parents who send their children to non-public schools would improve horizontal equity and be good public policy. This assumption does not rest simply on the fact that the continued existence of non-public schools lifts a large sum — perhaps $5 billion yearly — off the back of local government. Its broad philosophical base is the belief that our society desires and deserves alternatives to public education, and that governments committed to pluralism have the responsibility of creating conditions which make possible the development of reasonable educational options for citizens. How this can best be done is not examined here; instead, attention is devoted to the tax credit as one method which appears to have promise.

A. History of tax credits

The Federal Government has used the device of tax credits, i.e., credits against the Federal tax liability of individuals and firms, for many years and many purposes. The oldest dates from 1924-26 when the Congress enacted a credit for payment of State death taxes

up to 80 percent of the Federal tax liability of estates. This credit was effective in halting the prospective disintegration of State death taxation and providing the States with a larger share of death tax revenue. It is still in operation, although the revenue from it is now only equal to 10 percent of the Federal tax liability as compared with 76 percent in 1931. Another major credit is the 90 percent credit against the Federal unemployment tax of 3 percent on payrolls in covered employments. This credit, provided in 1935, was designed to push States into enactment of satisfactory unemployment insurance laws. It was successful: all the States were in the system by the middle of 1937, and just before this date the Supreme Court (Steward Machine Co. v. Davis) upheld the constitutionality of the device. A prime reason for use of the tax credit rather than a more centralized plan of unemployment insurance was fear of unconstitutionality.

Another and more recent and spasmodic credit has been the investment tax credit aimed at stimulating business firms to accelerate their rate of spending for new plant and equipment. It has been effective, although critics fuss over the form and base of that credit.

During the past two decades hundreds of bills have been introduced in the Congress which would have permitted individual income tax deductions or credits for outlays on education. Most of these bills have been limited to higher education though a few would have applied to expenses for elementary and secondary education. None has ever been reported out by the House Committee on Ways and Means or the Senate Finance Committee.

In 1961, when the Kennedy Administration was developing what eventually became the Elementary and Secondary Education Act, the White House gave considerable thought to a tuition credit for taxpayers with children in non-public schools. Since the proposed school-aid bill did not provide funds to non-public schools, it was felt that a Federal income tax credit for tuition paid to private and parochial schools might be justifiable in terms of giving roughly comparable treatment to the non-public schools. After consultation with the Treasury Department, the Ways and Means Committee, and Legal Counsel, the White House decided to drop the tax credit scheme from its school aid bill and substitute, instead, direct aid to non-public schools for specific purposes.(1)

The States have used tax credits (see Appendix A for more detail). Seven of them provide the personal exemption for their individual income tax through a tax credit. For example, Wisconsin allows a single person a tax credit of $10 which is equivalent to a personal exemption of $370 on the first $1,000 of net income. Use of a tax credit in lieu of a personal exemption is defended as keeping the tax reduction constant no matter what the size of the taxable income.

(1) Some Federal aid is presently filtering to non-public schools through the child-care deduction. In most cases, private school tuition qualifies as a "deductible child-care expense" when the mother is working or seeking work. Though the present level of benefits is quite low, the welfare reform bill passed by the House in 1971 would allow families with incomes up to $12,000 to deduct $1,000 to $1,500 as child-care expenses -- and private school tuition would qualify as a deductible expense.

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Recently some States have moved to reduce the regressivity of sales taxes and property taxes by giving a credit (usually a flat amount per person) against State income tax liability. Seven States give such a credit for consumption type taxes, and three States for property tax relief. When the allowable credit exceeds the tax liability, rebates are paid; when individuals have no income tax liability, refunds are prescribed. Evidence concerning how these refunds are handled, and how often they find and reach their targets, is not readily available.

Three States have recently enacted tax credit legislation in the field of education, and that of Minnesota is very relevant. Starting in 1971 it offers a credit for education costs of students in non-public elementary and secondary schools, the maximum being $50 for kindergarten students, $100 for elementary students, and $140 for high school students (see Appendix A for more detail).

Retirement income credit: The Federal credit which has more direct relevance to the proposal of a credit for educational expenditure of parents who send children to private schools is the credit for retirement income (other than that provided via OASDI and railway retirement). This credit is 15 percent of the first $1,524 for individuals, or $2,286 for husband and wife both aged 65 years or over. In 1969 the credit amounted to $171 million and was claimed on 1.6 million individual tax returns.

What was the origin of this credit? In 1941 the Treasury ruled that social security pensions were not to be included in adjusted gross income (AGI). The portion of retirement income (above what was contributed by the individual recipients) from other pensions was, on the other hand, included in AGI. A clear discrimination existed, therefore, against recipients of taxable pensions. Some relief was given in 1954 when a tax credit was provided. This credit also has been fairly satisfactory.

B. Justification of tax credits for educational expenses

In the United States, government has assumed almost the total cost of providing elementary and secondary education so long as it is publicly provided. As a result, the task of providing this kind of education has been substantially preempted by public schools, since more than 89 percent of enrollment in elementary and secondary schools is public. When elementary and secondary education is privately provided, the constitutional barrier stands in the way of governmental financial assistance to the institutions which render the schooling. These institutions, since they are debarred from direct receipt of public funds, must finance themselves in other ways, and, typically, one way has been to place direct charges upon parents who choose to enroll their children. These parents are not, of course, relieved from the taxes borne by all parents to finance the public schools. The charges borne by these parents are, therefore, extra and additional. Expression of this parental choice has recently become much more expensive, and this trend threatens the existence of many private schools.

The nub of this line of argument is simple. A discrimination exists against individuals (parents) who choose to send their children to private schools, since they bear extra educational costs not borne by parents who send their children to public schools. This discrimination could be alleviated through a tax credit or refund equal to all or some defined part of this extra cost. It would help to preserve the constitutional right of parents to send their children to non-public schools; it might recover a modicum of neutrality with respect to the choice made by poor and middle-income parents by lifting some of the cost obstacle in the way of sending children to non-public schools.

The example of the retirement credit is only approximate. When Congress provided this credit it rectified (in part) an inequity created by Treasury regulations. The inequity which might be rectified (in part) by a credit for the educational costs of non-public school pupils arises because non-public schools get no part of the governmental revenue raised at the State and local levels to finance elementary and secondary education. Such sharing is believed to be unconstitutional.

Could financial relief through a credit be provided by State and local governments? A tax credit to individuals requires that the tax liability of individuals be known, and here the individual income tax stands preeminent. State Governments with such a tax could provide

financial relief in approximately the same manner as could the Federal Government. This relief would, of course, be confined to individuals resident within the boundaries of each particular State; only the Federal Government could provide uniform relief to individuals across the nation.

The pressure on the State Governments to provide relief to non-public schools varies greatly from state to state because the numbers of pupils enrolled in such schools is uneven as the following table shows:

Percentage Enrollment by States in Non-Public Elementary and Secondary Schools, 1970-71

Percent	Number of States
0.0-4.9	15
5.0-9.9	15
10.0-14.9	12*
15.0-19.9	9
	51

*D.C. 12.6%

C. Design of the tax credit

1. For whom would a credit be available? The assumption is that it would be only for families with children in non-public schools. The financial discrimination -- the breach of horizontal equity -- is against them. To extend the credit to all families would be to retain the inequity in the financial treatment of families which have extra educational costs.

2. What would be the base for computing the credit? What educational costs should be eligible? The costs should, demonstrably, be school costs borne by parents of non-public school children and not borne by parents of public school children. To be used for the purpose of crediting, these costs would have to be identified by the person making a Federal income tax return. The only distinctive cost is tuition. Many other out-of-pocket costs of sending children to non-public schools -- gym fees, books, activity fees, etc. -- are, in some States, out-of-pocket costs of sending children to public schools. To allow these miscellaneous amounts as creditable would be to push all States toward instituting these charges in all schools. Yet even if substantial enlargement took place, the absence of tuition costs in public schools would keep the allowable credits for parents with public school children much below those for parents with non-public school children. The appearance that the tax credit had been generalized would be illusory.

The tentative conclusion is that the credit should rest only on tuition costs. It should be set at some low flat figure per pupil -- say $100, or possibly at $100 for elementary school pupils and $200 for high school pupils. To secure the right to take such a credit, a parent would simply have to have a child in regular attendance at an accredited non-public school.

3. Should rebates and refunds be allowed? A rebate is the sum to be paid the taxpayer when his allowable credit exceeds his tax liability. The logic of a credit is that rebates should be provided. What of the situation when families entitled to a credit have no income tax liability and do not make income tax returns? Should they be paid as a refund the amount of the credit? Once again the logic of a credit is that refunds be provided, since to deny benefits to those families which fall outside the income tax system would be to exclude families with the greatest financial need. The contention will, however, be offered that the logic should not be pressed so far -- that the connection between the income tax system and the welfare system is not so direct. No existing Federal tax credit provides rebates or refunds. To open this door by a new credit for educational expenses might be to open it for rebates and refunds of other tax credits. Rebates and refunds would, moreover, complicate administration. The Internal Revenue Service is accustomed to handling problems relevant to persons inside the income tax system and it could handle rebates; it is not equipped to handle problems relevant to persons outside it who do not make income tax returns.

D. Economic impact

A flat credit, modest in amount, would confine the benefits largely to families low in the income scale. A rich family with children in a high-cost private school would recover only a small percent of its educational expenses; a poor family, with children in a parochial school,

would recover a large percent. The credit could, of course, be refined by graduating it according to (a) adjusted gross income, or (b) taxable income, or (c) tax liability before credit of families, and by providing a cutoff so that, for example, families with an income tax liability of $2,000 or more would not be entitled to a credit. (The notch effects of a cutoff and of graduation would require attention. What is the "best" method is not examined here.)

What would be the <u>revenue loss</u>? (See Appendix B.) The enrollment in non-public elementary and secondary schools, 1970-71, was 5,282,567 pupils (10.9% of total enrollment) of whom 3,975,270 were in elementary and 1,307,297 in secondary schools. A credit of $100 with <u>complete coverage</u> would, therefore, have cost $528 million in 1970-71; one of $100 for elementary school pupils and $200 for secondary school pupils would have cost $659 million. If, as is suggested, the credit were confined to low and middle-income families, the cost figures would be reduced.

E. <u>Administrative problems</u>

1. Choice of a uniform flat amount would ease administration. The only evidence required from an income taxpayer would be that he had a child attending an accredited non-public school and that the educational charge paid by him was equal to or greater than the amount of the credit. If this charge were <u>less</u> than the allowable credit (say $100), then

only the amount of the actual tuition charge could be taken. But if the amount of the credit is set at a low figure, this will seldom happen. Moreover, tuition charges have risen and will continue to rise. A considerable time will elapse between, say, recommendation of a credit by the Commission and favorable legislation. During that time tuition charges which are low will rise so that none will be less than the credit.

A two-level credit ($100 for elementary school pupils and $200 for high school pupils), and a cutoff coupled with graduation, would create some difficulties of administration and add to the compliance costs. How to reconcile and resolve the various elements is not considered here.

2. Rebates and refunds: No serious administrative problems would arise in providing a cash rebate when the allowable credit exceeds the tax liability. The taxpayer is located by his tax return. How to reach families who do not file tax returns is a serious administrative problem which has not been faced by the Federal Government. Possibly it could be handled by the administrators who will handle the Family Assistance Plan (FAP) if and when this program is enacted.

3. How should <u>tuition</u> be defined to be eligible for a tax credit? To meet the constitutional test, the credit must be for the costs of secular education. A child in a non-public school should, therefore, be taking a normal, full-time program of secular courses approved by

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the appropriate State authority. Since the suggested credit is low -- less than the tuition charge in many cases -- tight and detailed conditions, and comprehensive and continuing surveillance concerning what kind of program is eligible, are unnecessary. In short, the definition of tuition and the conditions attached to the credit should be modest and simple. This would ease administration and avoid the "excessive entanglement" which the Supreme Court declared to be a fatal flaw in the Pennsylvania and Rhode Island cases decided June 28, 1971.

4. Some recent proposals for tax credits against State personal income taxes have argued in favor of a revenue-maintenance requirement, i.e., that in a State with an income tax, credit should be allowed only when State income tax collections have been <u>increased</u> by an amount which matches the <u>decrease</u> in Federal collections. Unless this is required, the effect of the credit in a State with an income tax would simply be to decrease the Federal taxes of persons with taxable incomes.

A revenue-maintenance condition in a tax credit for tuition expenses would require that the tuition charges of eligible non-public schools and the tuition payments of parents eligible for credits be increased by the amount received from the credits. This would, however, be neither feasible nor sensible. If no such condition were prescribed, credits received by parents would, in effect, reduce the cost of tuition. The non-public schools (assuming they did <u>not</u> raise tuition) would benefit only because enrollment of pupils would be stimulated.

Should an increase of tuition be barred for some limited time-period? While such a provision might, perhaps, protect against the charge that the credit money is being funneled (indirectly) to the non-public schools, it would serve no other purpose.

F. Constitutional Problems

The Commission's consultants on constitutional questions appeared to take a rather dim view of the likelihood that the tax credit outlined above would survive challenge in the courts. The premise on which this credit rests -- that parents who choose to send their children to non-public schools suffer a financial discrimination, and that a credit limited to them would not, therefore favor them -- did not appeal to the consultants. They inclined to the opinion that a credit for which parents of all school children are eligible would be more viable because of its generality and breadth. In terms of public finance, such a credit would operate very imperfectly to alleviate the breach of horizontal equity suffered by parents of non-public school children, and it would, besides, seem to push schools toward expanded use of charges.

The consultants on constitutional questions were firm and reassuring on one matter of current importance -- the growth of non-public schools, especially in the South, to escape desegregation. Professor Whalen states (pp. 47-48) in his paper:

"One point, fortunately, is absolutely clear: government cannot use private schools as a vehicle to escape desegregation of the public schools."

G. Treasury Objections

1. Controllability: A credit is less controllable than some budget items. It would not be subject to annual review and, once enacted, it would take legislation to repeal or alter it.

2. Would allowance of educational expenses (or simply tuition expenses) as deductions from adjusted gross income be better than use of a credit? A credit is, of course, a more powerful instrument than a deduction. If, for example, a family with one non-public school child had an adjusted gross income of $6,000, a taxable income of $2,400, and a federal tax liability of $400, then a credit of $200 would reduce the tax to $200. To gain a similar tax reduction through a deduction for educational expenses, the amount of the allowed deduction would have to be approximately $1,160. If expenses were to be a deduction, a limit would have to be set because actual expenses at non-public schools have a wide spread from parochial schools to high-cost private schools.

An important practical flaw is that, in 1969, only 46.3 percent of all returns itemized deductions; 53.7 percent took the standard deduction. Allowance of a deduction would do the families making these returns no good unless they shifted to itemization.

3. The customary Treasury reaction to steps which erode the Federal tax base is to oppose. One reason is that the Treasury does not like to lose revenue. It argues, moreover, that credits and deductions and exemptions conceal from the Congress and the public what the costs are in comparison with direct and explicit government expenses. This position has merit, but Congress has not been attentive to it; the erosion goes on. The attitude of Congress seems to be that if erosion is a better -- more efficient -- method than direct expenditure to achieve some Congressional objective, then the erosion method should be used.

APPENDIX A

STATE EXPERIENCE WITH TAX CREDITS

In recent years, many States have adopted tax credits for a variety of purposes.

Seven States (Colorado, Hawaii, Idaho, Indiana, Massachusetts, Nebraska, and Vermont) and the District of Columbia allow personal income tax credits for sales taxes paid on food and other consumer purchases. Ostensibly, these credits are designed to minimize the regressivity of the sales tax while maintaining a broad base of taxation. Typically, the credit is $10 or less per personal exemption, and in Hawaii, Massachusetts, Vermont and the District of Columbia the credit is limited to low-income taxpayers. In all eight cases, the taxpayer receives a rebate from the state if his credits exceed his tax liability.

Eleven States (Wisconsin, Minnesota, California, Vermont, Kansas, Colorado, Maine, New Jersey, Pennsylvania, Iowa, and Oregon) have now adopted tax credits to relieve low-income households from property tax overloads. With the exception of Oregon, however, the credit is restricted to homeowners and renters aged 65 and over. In most cases the credit is based on that part of property tax payment or rent that exceeds a pre-determined portion of family income. For example, in Vermont the relief is limited to that part of tax payment or rent which is in excess of 7 percent of household income.

In Colorado, Kansas, Minnesota, Vermont, and Wisconsin, the property tax credit is offset against the personal income tax, and the State gives rebates where the credit is in excess of the tax liability. In California, Maine, and Pennsylvania, the taxpayer files a separate form to claim a refund. In New Jersey, Iowa, and Oregon the credit is effected by actually reducing the property tax bill. Hawaii and Minnesota allow tax credits for all families who rent their dwellings. These renter credits are designed to reduce the inequity which results from renters not being able to make deductions equivalent to those allowed homeowners from property taxes and mortgage interest on their state income tax

returns. They also permit middle-income renters to recover some of the real property taxes that are passed on to them by landlords. In Hawaii, the credit varies from 1 to 2 percent of rent depending on the adjusted gross income of the taxpayer. If adjusted gross income is over $15,000, the credit is not allowable. In Minnesota the taxpayer may credit 3.75 percent of his rent against state income tax due, such credit not to exceed $45. In both States, cash rebates are made if credit is in excess of personal income tax liability.

In the area of education, only three States have enacted tax credit legislation: Vermont, Hawaii, and Minnesota. The State of Vermont grants a $10 credit against personal income tax liability to any resident taxpayer who is a full-time student for at least five months of the year. The effect of the credit is to reduce the cost of education for State residents relative to out-of-staters. However, no rebates are given if the personal income tax liability is less than $10.

In 1965, the State of Hawaii enacted a system of tax credits available to all families with children in school, be it kindergarten or college, non-public or public schools. The credit varies from $2 to $20 per student in grades K through 12 and from $5 to $50 per student in higher education, depending on family income. No credit is allowed if adjusted gross income exceeds $7,000. Supposedly, the education credits in Hawaii were adopted to alleviate the drop-out problem among children from low-income families. However, it seems unlikely that a student planning to drop out of school would be deterred by the prospect of a tax credit to his parents of $20 or less.

In 1971 the Minnesota Legislature enacted a law permitting credits against the State personal income tax for education costs of pupils in non-public elementary and secondary schools. Previously, the State had allowed families to include non-public education costs as an itemized deduction. For 1971 and 1972, the maximum allowable credit is $50 for kindergarten students, $100 for elementary students, and $140 for high school students. However, the credit permitted any individual household may not exceed $100 per pupil unit. In addition, the tax credit for parents with children in any particular school is constrained by a rather complex formula that takes into account the income and operating costs of that school. In no case may the credit exceed the parents' out-of-pocket outlay for tuition

and books. After 1972, according to the Legislation, the allowable credit will be increased roughly in proportion to increases in State foundation payments to the public schools. To claim the credit, the parent presents a receipt provided by the school to the State Department of Taxation along with his income tax return. If the credits exceed the tax liability, the State pays a rebate to the taxpayer.

The 130,000 non-public school students in Minnesota constitute about 12.3 percent of the total State enrollment. According to the Minnesota Department of Taxation, about 10 percent of those eligible for the credit and filing returns will receive rebates as their credits will exceed their income tax liability. The estimated revenue loss for 1972 is $11 million. Some concern has been voiced about the problem of reaching those families with children in non-public schools who are not presently filing tax returns -- perhaps 5 percent of those who would be eligible. However, the churches throughout the State have taken upon themselves the task of publicizing the availability of the new credit and encouraging those not currently filing tax returns to do so in order to receive refunds from the State. (It should also be noted that tuition in many non-public schools was increased immediately following the enactment of the tax credit.)

Minnesota has traditionally been one of the more innovative states in using tax policy to foster socially desirable objectives, and the new education tax credit for parents with children in non-public schools is clearly designed to alleviate the discrimination which exists against families electing not to use the tax financed public school system.

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APPENDIX B

ESTIMATED COSTS OF TAX CREDIT PROPOSALS
(Based on 1970 Enrollment and Income)

PLAN I

A credit of $100 for each child enrolled in an elementary or secondary non-public school:

5,282,567 students X $100 = $528,256,700

If this plan were expanded to cover both public and non-public students, the cost would be:

51,185,938 students X $100 = $5,118,593,800

PLAN II

A credit of $100 for each child enrolled in a non-public elementary school and $200 for each child in a non-public secondary school:

3,975,270 elementary students	X $100	=	$397,527,000
1,307,297 secondary students	X $200	=	$261,459,400
	Total:		$658,986,400

If this plan were expanded to cover both public and non-public students, the cost would be:

36,548,856 elementary students	X $100	=	$3,654,885,600
14,637,082 secondary students	X $200	=	$2,927,416,400
	Total:		$6,582,302,000

PLAN III

Similar to Plan II except that the credit is reduced by 2 percent of the amount by which adjusted gross income (AGI) exceeds $7,500:

This approach would direct most of the benefits to low-income families by reducing the credit when family income exceeds $7,500.

For example, if AGI were $10,000, the credit would be reduced by 2 percent of the difference between $7,500 and $10,000 — i.e., $2,500 X .02 = $50. If the family had a child in a non-public elementary school, its tax credit would be $50 ($100-$50). If the child were in high school, the tax credit would be $150 ($200-$50).

Under this proposal, the tax credit for elementary students would disappear when AGI reaches $12,500 and the credit for high school students would vanish at AGI of $17,500.

In 1970 21 percent of the children enrolled in non-public elementary schools were from families with AGI under $7,500 so these families would be entitled to the maximum allowable credit. Fourteen percent of the children enrolled in non-public high schools were from families with AGI under $7,500.

The estimated revenue loss from this plan, if limited to non-public school children, would have been as follows in 1970:

AGI under $7,500:		
Elementary	$82,700,000	
Secondary	$37,200,000	
		$119,900,000
AGI $7,500-9,999		
Elementary	$63,000,000	
Secondary	$42,525,000	
		$105,525,000
AGI $10,000-15,000		
Elementary	$8,835,000	
Secondary	$18,200,000	
		$27,035,000
AGI over $15,000		
Secondary	$114,300	
		$114,300
TOTAL REVENUE LOSS	=	$252,574,300

If this plan were extended to cover both public and non-public school children, the revenue loss would be approximately $2.3 billion.

PLAN IV

Tax credits based on out-of-pocket expenses:

A tax credit plan has been proposed that would permit a parent to deduct 50 percent of his "out-of-pocket" outlays for elementary and secondary education. In the case of non-public schools, the major out-of-pocket expense would be tuition. For public schools, creditable expenses would include all non-tax revenues that are collected by school systems -- fees, book charges, supplies, etc.

The credit would be reduced by 1 percent of the amount by which the adjusted gross income of the taxpayer for the year exceeds $10,000.

In 1970, tuition payments in Catholic schools amounted to about $500 million. For other non-public schools, the best estimate of tuition charges for 1970 is approximately $400 million. Public school fees and charges, excepting school lunch sales, amounted to $545 million in 1969.

The actual costing out of this proposal is difficult. Outlays that would be eligible for credit, as mentioned above, total about $1.45 billion at the present time. The revenue loss would not, therefore, have exceeded $722 million (i.e. 50 percent of $1.45 billion). It would fall short of this amount because of the reduction specified for returns with AGI's in excess of $10,000 (71 percent of all returns in 1969).

However, this estimate assumes that the relative consumption of private and public education remains the same. With the cost of private education made relatively cheaper by a credit, there may be a strong shift in consumption away from public education and toward private education.

At the present time, public schools in the South tend to use charge financing more than schools in other regions, so residents of these states would be the principal immediate beneficiaries of a tax credit based on fees and charges. It is conceivable that public school districts elsewhere would initiate use of direct charges vis-a-vis taxes with the knowledge that 50 percent of the levies could be passed on to the Federal Treasury.

The plan would be of most benefit to upper-income families and families with large out-of-pocket educational expenses. Consider the following example: A taxpayer with an AGI of $60,000 decides to send his two children to a high-priced boarding school that charges $3,000 tuition for each student. He is allowed a tax credit equal to 50 percent of $6,000, or $3,000. The credit is reduced by 1 percent of the amount by which his AGI exceeds $10,000.

Gross Credit	$3,000
Less: 1% of $50,000	500
Net Credit	$2,500

In other words, it now costs the taxpayer only $3,500 instead of $6,000 to send his children to private school. Any plan based on actual outlays should establish a maximum permissible dollar credit per student.

ENROLLMENT STATUS OF PRIMARY FAMILY MEMBERS

BY ADJUSTED GROSS INCOME

October, 1970

Enrollment Levels	TOTAL	Family Income Level (AGI)						
		Under $3,000	3,000 to 4,999	5,000 to 7,499	7,500 to 9,999	10,000 to 15,000	15,000 and over	Not reported
Elementary School (1-8)								
Public:								
Number (thousands)	32,574	2,573	3,909	6,124	6,384	7,526	3,648	2,410
Percent	100	7.9	12.0	18.8	19.6	23.1	11.2	7.4
Private								
Number	3,975	87	179	561	848	1,178	816	306
Percent	100	2.2	4.5	14.1	21.3	29.6	20.5	7.7
High School (9-12)								
Public:								
Number	13,330	840	1,306	2,240	2,386	3,399	2,106	973
Percent	100	6.3	10.4	16.8	17.9	25.5	15.8	7.3
Private:								
Number	1,307	7	54	125	243	364	381	133
Percent	100	0.5	4.1	9.6	18.6	27.8	29.2	10.2
Average tax		$ 122	321	612	941	1,527	5,534	
%returns nontaxable		51.6	10.3	2.7	-	-	-	

Source: Department of Commerce, Bureau of the Census, Series P-20, No. 222, and Office for Educational Research, University of Notre Dame. Computations by President's Commission on School Finance staff.

INCOME TAX CREDITS FOR TUITIONS AND GIFTS

IN NONPUBLIC SCHOOL EDUCATION

prepared for the
President's Commission on School Finance

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S Y N O P S I S

1. Nonpublic elementary and secondary schools have been in a rapid decline over the past five to six years which seems to be accelerating and it appears now that many and possibly most of those schools may be forced out of existence during the 1970s unless some type of action is taken to keep them alive.

2. The closing of most nonpublic schools could throw up to 5 million children on to the public school system and place an annual $4 to $5 billion burden on the taxpayers' backs. With few if any alternatives available, virtually all children would then have to get their education in the public schools, save for the children from the most affluent families. Many observers regard attendance of the same schools by all children to be the best preparation for life in a democracy. But it would certainly make a hollow shell of the natural right of the parents to direct their children's education, as defined by the U.S. Supreme Court in its unanimous decision in Pierce v. Society of Sisters.

3. The President made it a particular assignment of the Commission on School Finance to consider the financial problem in nonpublic education, especially in religious schools, and to recommend measures by which their decline can be halted and their threatened collapse prevented.

4. Several decisions of the U.S. Supreme Court rule out the appropriation of public funds for direct governmental subsidies to religious schools but permit tax benefits to churches and other religious institutions. It appears therefore that church-connected education can be effectively aided either by tax benefits of some kind or not at all.

5. The Internal Revenue Code now leaves about one-half of all personal income free from federal income taxation. Most of the numerous types of tax benefits are intended a) to establish greater horizontal equity, i.e., make taxes fairer by making allowance for special burdens, or b) to stimulate socially desirable activities by offering tax incentives.

6. Income tax deductions have long been permitted for special burdens such as state and local taxes, interest payments, casualty losses, medical expenses, etc., as well as for donations for religious, educational and charitable purposes. Considerations

of equity as well as social policy make it desirable to add tuitions to the list; this seems to be the most effective method, and possibly the only method, by which parents can be aided in exercising their right of choice and church-connected schools can be helped to survive.

7. Because of the progressive income tax rate scale, deductions confer proportionately greater benefits on taxpayers in high income brackets than on low or middle income persons. This lopsided situation can be rectified by using tax crecits -- deductible from tax liability -- instead of deductions from adjusted gross income. I suggest that the privilege which is now enjoyed only by taxpayers in the highest income bracket -- to offset 70% of their donations to schools against their tax liability -- be extended to taxpayers at all income levels. This would effectively stimulate contributions among middle and lower income persons.

8. Tuition tax credits can help parents to augment their support of nonpublic schools without placing a commensurate burden on them. If well designed, tuition tax credits are on firm constitutional grounds and will stand up against any conceivable constitutional challenge.

I suggest a 70% tax credit for tuitions in all regular schools. Such a credit could, for example, apply to tuitions between $100 and $300 in elementary schools and between $100 and $500 in secondary schools, with an upper income cutoff. Its annual cost may be estimated at $900 million, which is less than one-fourth of the expense of educating those children in public schools.

9. Public schools, as well as homeowners, could be aided by the granting of income tax credits for residential school property taxes.

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The nonpublic elementary and secondary schools in the United States have long been an integral part of the nation's educational establishment -- supplementing in an important way the main task of our public school system. The nonpublic schools provide a diversity which our educational system would otherwise lack. They also give a spur of competition to the public schools -- through which educational innovations come, both systems benefit, and progress results.....

If most or all private schools were to close or turn public, the added burden on public funds by the end of the 1970s would exceed $4 billion per year in operations, with an estimated $5 billion more needed for facilities.

.....

This government cannot be indifferent to the potential collapse of such schools.

The specific problem of parochial schools is to be a particular assignment of the Commission.

In its deliberations, I urge the commission to keep two considerations in mind. First, our purpose here is not to aid religion in particular but to promote diversity in education; second, that nonpublic schools in America are closing at the rate of one a day.

From: President's Message on Education Reform, March 3, 1970

Decades of dedicated and persistent efforts of nonpublic schools, secular and religious, and their protagonists to obtain financial support from state or federal funds came to naught when the U.S. Supreme Court in the Lemon and Di Censo decisions in June 1971 declared such programs in Pennsylvania and Rhode Island -- and by implication anywhere else -- to be violative of the "no establishment" clause of the First Amendment. The Court's position was foreshadowed nearly a quarter century earlier by its rule in the Everson case that no public funds can be expended to support religious activities or institutions. When several states in recent years devised elaborate schemes to aid private schools while restricting expenditures of public funds in denominational schools to the teaching of secular subjects, the Court concluded that such controls would lead to an "excessive entanglement" between church and state.

So, no matter which way the states and the private school groups turned, whether they took care to prevent spending for sectarian purposes or whether they did not, they were effectively blocked in attempts to secure governmental appropriations for church-connected schools. The Lemon decision ended in all likelihood, at least for as far as we can see ahead, the organized movement for such aid. It did not, however, lock the door to other forms of governmental assistance to nonpublic education.

Can Government Aid Church-connected Education?

Well over 90% of the enrollment in nonpublic elementary and secondary education is in religious schools, about 83% just in Catholic schools, parochial, diocesan or run by religious orders. A drive to obtain governmental aid for secular nonpublic schools only would lack sufficiently broad support to offer much hope for success. Moreover, to exclude denominational institutions from a general assistance program would be tantamount to offering them an incentive premium for cutting their church ties and come close to imposing a penalty on the exercise of religion. In all likelihood then the choice lies between an aid program available to all nonpublic schools and no aid program at all.

But religious schools are up against the Supreme Court's forceful pronouncement in Everson when, speaking through Mr. Justice Black, it said:

> The establishment-of-religion clause of the first amendment means at least this: .... No tax in any amount, large or small, can be levied to support any religious activities or institutions, whatever they may be called, or whatever form they may adopt to teach or practice religion.

Attempts to stress the dual nature of religious schools and the secular side of their teaching received short shrift by the Court in Lemon when it found the parochial school system to be "an integral part of the religious mission of the Catholic Church."

The Court, however, took pains to point out on several occasions that it was not opposed to nonpublic or religious schools as such and that it was not ruling against them or even against governmental assistance to them. It was merely establishing the rules on assistance, then under review, which it held to run afoul of the "no establishment" clause.

In the Zorach case (1952) Mr. Justice Douglas delivered / a ringing declaration for the Court:

> We are a religious people whose institutions presuppose a Supreme Being.... When the state encourages religious instruction or cooperates with religious authorities by adjusting the schedule of public events to sectarian needs, it follows the best of our traditions. For then it respects the religious nature of our people and accomodates the public service to their spiritual needs. To hold that it may not would be to find in the Constitution a requirement that the government show a callous indifference to religious groups. That would be preferring those who believe in no religion over those who believe.

This expanded on the Court's decision in the landmark case of Pierce v. Society of Sisters (1925) in which it declared unconstitutional an attempt by the state of Oregon to establish a monopoly for the public schools and to eliminate private schools from the general education process: "The child is not the mere creature of the state; those who nurture him and direct his destiny have the right, coupled with the high duty, to recognize and prepare him for additional obligations."

While voiding the Pennsylvania and Rhode Island programs, Mr. Chief Justice Burger clarified the Court's position in Lemon:

> Finally, nothing we have said can be construed to disparage the role of the church-related elementary and secondary schools in our national life. Their contribution has been and is enormous. Nor do we ignore their economic plight in a period of rising costs and expanding need. Taxpayers have been spared vast sums by the maintenance of these educational institutions by religious organizations, largely by the gifts of faithful adherents.[1]
>
> The merit and benefits of these schools, however, are not the issue before us in these cases. The sole question is whether state aid to these schools can be squared with the dictates of the religion clauses.

The Lemon decision points at the danger of support programs posed "by the need for continuing annual appropriations and the likelihood of larger and larger demands as costs and populations grow." It contrasted such programs with the issue in a case it had decided a year earlier: "But in Walz we dealt with a status under a state tax law for the benefit of all religious groups. Here we are confronted with successive and very likely permanent annual appropriations that benefit relatively few religious groups."

In other words, the Court found no reason why government could not aid religion as such or religious schools, provided this was not done by the spending of public funds but by granting tax benefits available to all, including religious institutions. The decision was directed, as Mr. Justice Brennan explained in his concurring opinion, against "the provision of a direct subsidy from public funds for activities carried on by sectarian educational institutions." (emphasis supplied)

In the Walz decision (1970) the Chief Justice stated:

> Obviously a direct money subsidy would be a relationship pregnant with involvement and, as with most governmental grant programs, could encompass sustained and detailed administrative standards....
>
> The grant of a tax exemption is not sponsorship since the government does not transfer part of its revenue to churches but simply abstains from demanding that the church support the state.... (emphasis supplied)

The Court justified its distinction between the grant of governmental funds and the grant of tax benefits by pointing out that the state

> has granted exemption to all houses of religious worship within a broad class of property owned by nonprofit, quasi-public corporations.... The State has an affirmative policy that considers these groups as beneficial and stabilizing influences in community life and finds this classification useful, desirable, and in the public interest....

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[1] The Lemon decision came more than a year after the President's Message on Education Reform and it is apparent that the Court had taken due notice of the contents of that message.

> The exemption creates only a minimal and remote involvement between church and state and far less than taxation of churches. It restricts the fiscal relationship between church and state, and tends to complement and reinforce the desired separation insulating each from the other....
>
> Few concepts are more deeply embedded in the fabric of our national life, beginning with pre-revolutionary colonial times, than for the government to exercise at the very least this kind of benevolent neutrality toward churches and religious exercises generally....

That the grant of tax benefits to churches is constitutionally permissible was recognized by the Supreme Court nearly 80 years before Walz in Bell's Gap Railroad Company v. Pennsylvania, 134 U.S. 232 (1890):

> [The equal protection clause] was not intended to prevent a state from adjusting its system of taxation in all proper and reasonable ways. It may, if it chooses, exempt certain classes of property from any taxation at all, such as churches, libraries and the property of charitable institutions....
>
> We think we are safe in saying that the Fourteenth Amendment was not intended to compel the state to adopt an iron rule of equal taxation.

More than a century earlier, in 1785, the Continental Congress authorized large land grants for school purposes and, two years later, in the year of the Constitutional Convention, for religious purposes while issuing a ringing exhortation to future generations in the famous Northwest Ordinance:

> Religion, morality, and knowledge being necessary to good government and the happiness of mankind, schools and the means of education shall forever be encouraged.

It is significant that among the benefits to be derived from school education, religion was mentioned first, just as churches were listed first in more recent acts of Congress granting tax benefits for a multitude of charitable activities. Religion was an integral part of the curriculum in most schools in the days of the Northwest Ordinance, as it had been at the time when the concept of universal education arose in New England in the "Ye Olde Deluder Satan" law of the Massachusetts Bay Colony in 1647.

Religious instruction can no longer be provided in the public schools, under First Amendment interpretations from Everson to Engel v. Vitale. This makes it even more important to uphold the right of the citizen to send his children to a school in which religion can be taught without subjecting him to an excessive economic penalty. But that right becomes a hollow shell if there are no such schools available or if the cost of attending them is prohibitive.

It has been said that "the only honest issue in the parochial aid controversy is the religious issue. Must the taxpayer contribute to the support of a religious institution

the doctrines of which he cannot accept?" (D. L. Judd in Saturday Review, February 20, 1971).

This question has been conclusively answered by the Supreme Court:

Government (i.e., the taxpayer) must not and cannot contribute to the support of a religious institution through the expenditure of tax funds. It may aid religious institutions by foregoing the collection of taxes it would otherwise collect. The question now is to the best form in which such aid can be rendered without conflicting with the "no establishment" and "equal protection" clauses.

Tax Benefits: Exclusions, Exemptions, Deductions, Credits

$361 billion of personal income went federally untaxed in 1969, nearly one-half of all personal income in the United States.

These are the major types of benefits under existing tax law:[1]

1) Exclusions.

Notwithstanding the all-inclusive definition in the Internal Revenue Code of 1954 of income to be reported and taxed ("...all income from whatever source derived....") many types of income are excluded by statute, court decision or administrative rule: social security and welfare benefits, unemployment and workmen's compensation, veterans pensions, gifts and inheritances, scholarships and fellowships, interest on state and municipal obligations, and dozens of others.

2) Exemptions.

The only exemption in the federal income tax law is the personal exemption which amounted to $600 per person from 1948 to 1969, and will total $750 in 1972. An added exemption is permitted for a person who is 65 or over or blind. State property tax laws, no matter how inclusive their general definitions may be, exempt many types of property owned by other governments, by churches, religious, charitable, educational organizations, in some cases veterans, homesteads and others. Some of the sales tax laws exempt such purchases as food consumed off the premises, prescription drugs, etc.

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[1]As defined in the Internal Revenue Code of 1954.

3) Deductions.

From its inception in 1913 the income tax law has permitted a number of deductions for certain expenditures, whose range has since been widened: interest, state and local taxes, medical costs, contributions to certain nonprofit institutions such as religious, educational, scientific and charitable organizations, casualty losses, medical expenses, alimony payments, etc.

4) Credits.

Deductions and exemptions (Nos. 2 and 3 above) are subtracted from adjusted gross income to establish taxable income, to which the rates of the tax scale are applied to compute the tax. Credits may be subtracted from the computed tax to arrive at the final net tax liability. Tax credits are commonly granted as a percentage of a particular item of expenditure or income and may go up to 100%. Typical examples are the retirement credit, investment credit, taxes paid to foreign governments, credit for state inheritance taxes against federal estate taxation, credit for state unemployment taxes against federal employment taxes, etc. The Revenue Act of 1971 created two new types of income tax credits: for political contributions after 1973 and for hiring workers through the government work incentive program. Several states allow credits against their income tax for sales tax or certain property taxes.

The basic difference between an income tax deduction and an income tax credit is this: If a man contributes $100 to a charitable purpose he is presently entitled to subtract $100 from his adjusted gross income (unless he uses the standard deduction). This means that if he is in the lowest taxable income bracket he gets a net reduction of $14 on his tax liability. He must shoulder $86 out of his $100 gift. If a man in the top income bracket contributes $100, he reduces his income tax liability by $70, so that the net cost to him of his $100 gift is only $30.

That, of course, is simply the result of our progressive rate scale, but it does not seem quite fair and has been called an "upside-down subsidy." The main effect of this system, which has long been criticized, is a lopsided concentration of gift-giving

in the top income brackets and heavy dependence of educational and other institutions on a small number of wealthy individuals and families.

Tax benefits now available to schools, public or private, consist of the exemption of their income and property from income and property taxes, exemption of certain transactions from sales or excise taxes in some jurisdictions, and the deductibility to donors of their contributions.

Exemption from taxation of their own income and property is of course very helpful to the benefited schools. It reduces their expenses. But it does not help them increase their income, which is what they urgently need. This cannot be done from governmental sources directly. But government can provide incentives which could substantially boost the schools' revenues from their major private sources, gifts and tuitions. Deductibility of donations is of tremendous value, and often essential to the schools' survival. But it is a far less effective stimulant than tax credits for donations would be.

Tax benefits for payment of tuitions to educational institutions have been under consideration for about twenty years. Wilber Katz, then at the University of Chicago Law School, may have been the first to suggest, not long after the Everson decision, that a tax deduction for tuition paid to religiously connected schools would be permissible although the Court might not uphold direct payments.[1]

Several hundred bills were introduced in Congress in recent years that would grant tax benefits for payment of tuitions to educational institutions, mostly at the collegiate level. Many of them had broad bi-partisan sponsorship and one plan was

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[1]Wilber G. Katz, "Canon Stokes on Church and State," The Living Church, September 14, 1951; same author, "Freedom of Religion and State Neutrality," 20 University of Chicago Law Review, 1953, p. 440.

passed by the Senate on three occasions by large majorities. But no such bill was ever enacted.[1]

Proposals to expand tax benefits for schools or parents supporting them cannot be seen in the proper perspective or adequately evaluated without a review of the broad picture of tax benefits now used in the federal income tax.

Complaints have been voiced for about fifteen years about an erosion of the income tax. The federal income tax appears to be punctured by numerous loopholes through which huge amounts of income escape from bearing a share of the overall burden. Repeated attempts to close or narrow some of the major loopholes have had only limited success. The tightening of one loophole by Congress was usually accompanied by the widening of others. Loophole closing seems to be a truly Sisyphean task.

As mentioned before, $361 billion of personal income went untaxed in 1969. The percentage of all income that is not taxed has been declining, as Table I shows, due largely to inflation and a rising income level. In all likelihood, however, the percentage of income enjoying freedom from taxation will increase as a result of reforms authorized in the Internal Revenue Acts of 1969 and 1971.

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[1]The record of the movement to secure tax credits in higher education is presented in my book Crisis in College Finance?, The Institute for Social Science Research, Washington, 1965, Chapter 10. Also, in a paper I prepared for the Joint Economic Committee of Congress: "Federal Assistance to Higher Education Through Income Tax Credits," The Economics and Financing of Higher Education in the United States, Joint Economic Committee, 1969, pp. 664 ff.

The graduated percentage credit plan for higher education which I had proposed to the Senate Finance and Education Committees in 1963 was passed by the Senate for the third time on November 16, 1971, with a vote of 56:27. Several of the Senators who voted in the negative stressed in the preceding debate that they favored the idea but thought that it should be postponed because of the current huge budget deficit. The credit was subsequently eliminated by the Senate-House Conference Committee.

Table I

PERSONAL INCOME AND FEDERALLY TAXED INCOME 1954-1969

	Personal Income	Taxable Income	Nontaxed Personal Income	Nontaxed Income as a percentage of Personal Income
	billions			percent
1954	$290.1	$115.3	$174.8	60%
1960	401.0	171.6	229.4	57
1968	688.9	352.8	336.1	49
1969	750.3	389.1	361.2	48

Source: Economic Indicators, Council of Economic Advisers.
Statistics of Income: Individual Income Tax Returns, Internal Revenue Service; respective years.
(This is also the source for the income tax data listed in the succeeding tables)

The $361 billion of income that went untaxed in 1969 can be divided into three major categories:

Table II

	billion
Difference between Personal Income and Adjusted Gross Income (mostly exclusions such as social security benefits, welfare, etc.)	$146
Personal exemptions ($600 per taxpayer and dependent)	124
Personal deductions	102
	$372
Offset items	- 11
	$361 [1]

[1] Contrary to what is widely believed, most of the nontaxed income is received by persons in the low and middle income brackets. Because no breakdown by income class has been available for personal income since 1964, accurate overall data cannot be given. The $146 billion difference between personal income and adjusted gross income derives largely from social benefits such as social security, welfare and unemployment benefits and is concentrated in the low income brackets. More than 90% of the $215 billion difference between adjusted gross income and taxable income accrues to persons in low to upper middle income brackets:

ADJUSTED GROSS INCOME AND TAXABLE INCOME BY INCOME BRACKETS, 1969

	Adjusted gross income	Taxable income	Untaxed adjusted gross income	Percent of adjusted gross income untaxed
	billions			percent
Adjusted gross income class:				
Under $10,000	$237.5	$128.3	$109.2	46%
$10,000 to under $25,000	279.9	192.7	87.2	31
$25,000 and over	86.3	67.4	18.9	22%
	$603.7	$388.4	$215.3	36%

$91 billion in personal deductions in 1968 are divided as follows: (these data were not tabulated for 1969 by the Internal Revenue Service).

Table III

DEDUCTIONS ON FEDERAL INDIVIDUAL INCOME TAX RETURNS, 1968

	billion
State and local taxes	$24.4
Interest paid	18.5
Contributions	11.1
Medical expenses	8.5
Employee expenses	2.3
Other deductions	4.4
All itemized deductions	$69.2
Standard deductions	22.1
All deductions	$91.3

Itemized contributions have been increasing, but maintained a steady rate of about 2% of the adjusted gross income on all returns over the past ten years. A decline may be expected to result from the liberalization of standard deductions in 1969 and a further drop may follow the Revenue Act of 1971.

Table IV

ADJUSTED GROSS INCOME AND CONTRIBUTIONS
ON ITEMIZED RETURNS 1958-1968

	ADJUSTED GROSS INCOME on all individual returns	CONTRIBUTIONS on returns with itemized deductions	Percent contributions
	- billions -	- millions -	- percent -
1958	$281.2	$5,694	2.0%
1960	315.5	6,750	2.1
1962	348.7	7,516	2.2
1964	396.7	8,327	2.1
1966	468.5	9,122	1.9
1968	554.4	11,139	2.0
1969	603.5	N.A.	N.A.

No breakdown is available of the contributions by class of recipients -- schools, hospitals, churches, etc. -- but we may estimate that about $1.8 billion went to educational institutions in 1968, mostly at the collegiate level. Donations to elementary and secondary schools probably accounted for only a small fraction of the total.

What Are Tax Deductions For?

The principal author of the Internal Revenue Code of 1954 (under which we still operate) Dan Throop Smith, then Deputy to the Secretary of the Treasury,[1] declared in 1957: "Most, if not all, of the allowed deductions are intended to increase the fairness of the tax."[2] Subsequently he wrote: "All of the deductions allowed in computing the taxable income of individuals are designed to give relief to the taxpayers benefiting from them and thereby make the law fairer."[3]

C. Harry Kahn of Rutgers University, author of the standard work on tax deductions, defined two purposes:

a) to provide greater equity

b) to promote desirable activities.[4]

a) Deductions to provide greater equity.

All exemptions and most existing deductions fall into this category. They aim to refine the definition of income so as to come closer to a "net income concept which expresses true taxpaying capacity. Therefore, they reduce the tax base by taking into consideration special burdens borne by the particular taxpayer. Of two men with the identical gross income, one may have more dependents, heavier medical expenses, casualty losses, state and local tax liabilities. So he is less able to pay federal income tax than the other. Exemptions and deductions are intended to "differentiate between taxpayers whose incomes, though apparently equal, are of different sizes in some relevant sense."[5] They aim to provide greater horizontal equity.

The cause of a man's reduced taxpaying capacity may be completely beyond his control, such as a misfortune or Act of God, but it need not be. It can be due to his own

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[1]Now a senior research fellow at the Hoover Institution.

[2]"General Policy Problems of Tax Differentials" in: Income Tax Differentials, Symposium by the Tax Institute, 1958, p. 6.

[3]Dan Throop Smith, Federal Tax Reform, McGraw-Hill Book Co., New York, 1961, p. 90.

[4]C. Harry Kahn, "Personal Deductions in the Individual Income Tax," Tax Revision Compendium, Committee on Ways & Means, House of Repr., 1959, pp. 392 ff. Income Tax Revision, Panel Discussions, Committee on Ways & Means, House of Repr., 1959, pp. 165-68.

[5]C. Harry Kahn, Personal Deductions in the Federal Income Tax, National Bureau of Economic Research, Princeton University Press, 1960, p. 174.

deliberate action. Can it be argued that the number of a man's dependent children is not subject to his power of decision? Yet, the laws allow him an exemption of $750 for each dependent in 1972. A man may have a diseased tooth extracted for $10; or, he may have it treated and crowned at a cost exceeding $100. He deducts for income tax purposes the cost of whatever treatment he chose. Even the amount of state and local taxes a man pays is in part dependent on his personal decisions on location, type of investment, timing of purchase or sale, choice between taxable and nontaxable securities, etc. He may borrow money and deduct the interest, or he may postpone a purchase and not borrow.

If a taxpayer has a justifiable reason to assume a particular burden -- such as for example the adoption of children or some other act of conscience or compassion -- he is entitled to a tax benefit, because he does bear a special burden, even if it is brought about or increased on his own volition. The law permits a wide discretion.

b) Deductions to promote desirable activities.

The law provides a financial incentive to engage in or expand activities which are regarded to be in the public interest. Some of them are of the type that would have to be undertaken and financed by government if they were not provided by voluntary action. Hospitals, schools, libraries, museums are in that category. Congress may find that it is less costly to the taxpayer if government offers individuals or organizations an incentive to devote their own funds for such purposes than to have to underwrite the entire cost through taxes. More importantly, it may deem it preferable that certain activities be carried on under private auspices, partially or fully, and not be under direct governmental control or become a governmental monopoly. A greater diversity is often desirable so as to permit the widest range of individual freedom, consistent with the obligations and purposes of government.

Some deductions are allowed for activities which would not be carried on by government. This applies particularly to donations for churches and other religious institutions and organizations. Government could not, under the "no establishment" clause, expend tax-collected funds for such activities. But it is equally clear that government may encourage -- and materially aid -- such purposes by indirection. In the Walz decision the U. S. Supreme Court was emphatic in stating that though government may not spend public funds for religious purposes, it may indirectly aid them by foregoing the collection of taxes which it would otherwise impose.

Do Tuitions qualify under our System of Tax Deductions?

It appears that recognition of tuitions would policywise be justified under both of the above listed categories:

a) If Mr. Smith sends his children to a private school and pays tuition, he thereby assumes a special burden which would otherwise devolve upon the general taxpayer. Mr. Brown whose children attend public schools would be paying higher taxes if Mr. Smith did not send his children to a private school. Mr. Smith's burden is voluntary because he could save himself money by sending his children to a public school. If he did, Mr. Brown's added taxes would not be voluntary. It is, therefore, in Brown's interest to keep the Smith children in a private school -- and it would be prudent policy to provide their father with an incentive to do so.

Also, the man who procreates or adopts children thereby assumes a burden, voluntarily. For this he is given a tax benefit -- a dependent's exemption -- although there would have been no burden on the taxpayer or anybody else if he had not procreated those children. Why should not a parent who voluntarily assumes the obligation of paying for his children's education be granted commensurate material recognition?

Moreover, if a taxpayer donates money to a private school, he may deduct the amount for income tax purposes. If he pays tuition he may, at present, not deduct it.

Most religious schools are built from the proceeds of donations to a church which are tax-deductible. An estimated two-thirds or more of the operating cost of Catholic schools (which account for 83% of the enrollment in all private schools) is derived not from tuitions but from church funds which, when contributed to the church, are tax-deductible. Would it not be simpler to grant equal rights to tuitions? Why distinguish between donations and tuitions?

The charges and fees of a hospital run by a religious order can be deducted by the payer for income tax purposes. Why should the fees charged by schools not be accorded similar treatment?

Horizontal equity among taxpayers will be improved if the one who pays tuition to a private school -- which, if public, would have to be financed by the taxpayer -- is granted recognition of his burden.

b) Diversity in education can be maintained only as long as private schools operate. If private schools succumb to financial pressure, the public schools will enjoy a complete monopoly and the right of the citizen to send his children to a school of his choice -- affirmed in the Pierce decision of the Supreme Court -- will become hypothetical. It already is a mere nominal right for those who do not have a private school of their choice nearby or cannot afford to pay their charges. This means that often only rich -- or fortunate -- people have a true freedom of choice.

Proponents and opponents of tuition aid or other forms of assistance to private schools are really not divided by their legal views on whether such aid is constitutional or whether it is equitable. They differ on whether private schools as such are desirable. Some opponents hold that private schools are a divisive phenomenon on the American scene. They believe that in a democracy all children ought to attend the same state schools, and that the existence, and certainly an encouragement or growth, of private schools works to the detriment of the public schools.

Whether expanded tax benefits can be granted to nonpublic school education is no longer a constitutional question. It is a policy question to be decided by Congress -- and state legislatures -- according to their understanding of the best interest and wishes of their constituents and of the equity among taxpayers.

Congress first authorized tax deductions for contributions "to religious, charitable, scientific and educational nonprofit organizations" up to 15% of an individual's income in 1917. It subsequently raised the limit to 20%, then to 30% and finally, in 1969, to 50% of adjusted gross income.

To justify the boost to 20% in 1952, the Senate Finance Committee explained:

> Your committee is of the opinion that by increasing the 15 per cent limit to 20 per cent, much-needed relief will be given to colleges, hospitals, and other organizations who are becoming more and more dependent upon private contributions to enable them to balance their budgets and carry on their programs.... Your committee believes that it is to the best interest of the community to encourage private contributions to these institutions and it is believed that this amendment will provide some assistance in this respect.[1]

In proposing to raise the ceiling to 30% for gifts to churches, educational institutions and hospitals (but not to other organizations) the Ways and Means Committee in 1954 specified the purpose: "...to aid these institutions in obtaining the additional

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[1] Deductibility of Proceeds from Sporting Events ... and Charitable Contributions by Individuals, Committee on Finance, Senate Report No. 1584, 1952, p. 2.

funds they need, in view of their rising costs."[1]

The same committee justified a further boost from 30% to 50% in 1969 "in order to strengthen the incentive effect of the charitable contributions deduction."[2]

The record of tax deductions over the past half century indicates clearly that the Congress strongly favors this method of tax relief for special burdens, whether accidentally inflicted and inescapably suffered or voluntarily assumed, that this applies especially to churches, schools and hospitals, and that this is in keeping with the wishes of the American people.

In view of the financial crisis in the private schools, which are rapidly declining and threatened with collapse, an extension of the presently available tax benefits is justifiable and advisable.

There seems to be no need for raising the percentage of income beyond the 50% established in 1969 -- although some institutions may suffer from the elimination of the unlimited deduction in special cases. But to change from deductions to credits would be of tremendous help. By attracting millions of persons in the middle and lower income brackets who presently contribute little if anything, added funds would be infused and the dependence of educational institutions on a small number of wealthy persons reduced.

The most effective method of aiding nonpublic school education at this time would, however, be the establishment of tax credits for tuitions. A number of objections to tuition tax credits have been raised which merit consideration.

Objections to Tuition Tax Credits.

These appear to be the most frequently heard arguments against extension of tax benefits to tuitions:

1. "To grant a tax benefit for tuition paid to private schools would discriminate against children attending public schools who pay no tuitions. Almost all state constitutions

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[1] Internal Revenue Code of 1954, Committee on Ways and Means, House Report No. 1622, 1954, p. 29.

[2] Tax Reform Act of 1969, Committee on Ways and Means, House Report No. 91-413, p. 51.

require public school attendance to be free. Parents who send their children to a private school made a decision which the general taxpayer should not be called upon to finance."

It is obviously true that attendance at a private school and the payment of tuition are voluntary. So are contributions to churches, schools and hospitals -- which are tax deductible. Someone who makes no such contribution has nothing to deduct. A person may have the choice of being treated at a free clinic or by a private physician or at a fee charging hospital. If he opts for the free clinic he has nothing to deduct. If a man buys a car and pays sales tax thereon, he can claim a deduction. If he foregoes the purchase he loses that deduction.

No man has to procreate or adopt children. But if he does, and thereby incurs expenses he could have avoided, he is entitled to tax exemptions for his dependents.

The number of examples could be multiplied, but the lesson is clear:

The principle in our tax law is that a tax benefit is granted to a taxpayer who is shouldered with or assumes a special burden. This does not discriminate against an individual who bears no such burden and therefore gets no benefit.

It is clearly established that a tax law may classify activities, impose heavier rates on some taxpayers, activities or property than on others, exempt some partially or wholly while taxing others, and that this does not violate the "equal protection" or "due process" clauses of the 14th Amendment.

In Walters v. City of St. Louis, 347 U.S. 231 (1954) the U.S. Supreme Court found:

> Equal protection does not require identity of treatment. It only requires that classification rests on real and not feigned differences, that the distinction have some relevance to the purpose for which the classification is made, and that the different treatment be not so disparate, relative to the difference in classification, as to be wholly arbitrary.

In New York Rapid Transit Corp. v. City of New York, 303 U.S. 573 (1938) the Court said:

> I. Classification. No question is or could be made by the Corporation as to the right of a State, or a municipality with properly delegated powers, to enact laws or ordinances, based on reasonable classification of the objects of the legislation or of the persons whom it affects. "Equal protection" does not prohibit this. Although the wide discretion as to classification retained by a legislature, often results in narrow distinctions, these distinctions, if reasonably related to the object of

> the legislation, are sufficient to justify the classification.... Indeed, it has long been the law under the 14th Amendment that "a distinction in legislation is not arbitrary, if any state of facts reasonably can be conceived that would sustain it..." ..."What satisfies this equality has not been and probably never can be precisely defined." Magoun v. Illinois Trust and Savings Bank, supra, 293. [170 U.S. 283 (1898)]
>
> The power to make distinctions exists with full vigor in the field of taxation, where no "iron rule" of equality has ever been enforced upon the states.... A state may exercise a wide discretion in selecting the subjects of taxation....

In other cases, too numerous and extensive to be quoted here, the U.S. Supreme Court has recognized the lawmakers' broad authority to tax and exempt from taxation according to their own judgment.[1]

If an individual -- or an institution -- can be exempted, for a good reason, from paying the property tax, he can be exempted from paying the income tax. And if he can be exempted from paying the entire tax he can be exempted from paying a part of the tax -- if a valid justification for making a distinction can be adduced.

Over the past 58 years Congress has established a large number of exclusions, exemptions, deductions from and credits against the federal income tax. I can see no reason why a credit or deduction for tuitions and fees paid to an educational institution should be less secure in its constitutional standing than any of the existing tax differentials, as long as it is not discriminatory or capricious.

That some schools charge no tuition is no more a valid objection to permitting benefits for tuitions than free medical clinics are an argument against allowing medical deductions. Nor is there a difference between a deduction and a credit that has relevance to their legal standing.

Since schools are granted several types of tax benefits that have never been questioned and appear secure, a credit for tuition payments would raise no issue that has not long been regarded as settled.

The fact that students attending public schools would derive no direct benefit from tuition tax credits does not justify a charge of unequal treatment. There is no constitutional requirement that every single law or public program must provide benefits for everybody. It is not unusual that a measure is adopted which in effect benefits

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[1] See particularly: Ohio Oil Co. v. Conway, 281 U.S. 146 (1929), Great Atlantic & Pacific Tea Co. v. Grosjean, 301 U.S. 412 (1937).

only one segment, often to rectify an existing inequity. The proposed credit would be given for payment of tuition at any school, public or private. Surely it cannot be held that children attending private schools receive governmental benefits and children in public schools do not. Public school children have virtually the entire cost of their education paid from public funds. They do not benefit from tuition tax credits because state constitutions do not permit tuition to be charged in public schools. Similarly, children in private schools do not have the cost of their education paid from public funds because the U. S. Constitution, as interpreted by the Supreme Court, does not permit it. Therefore they might be given another, far smaller, benefit -- credit for tuitions paid.

2. "To grant an income tax deduction or credit for tuitions paid to a school is unfair and discriminates against those who have no income tax liability."

If this line of reasoning were correct, all deductions, exemptions, credits, etc. would have to be called discriminatory. If, for example, a man's income consists only of excludable items such as social security, veterans pensions or fellowships, he derives no benefit from his personal exemptions or deductions. If a man's exemptions and deductions exceed his adjusted gross income, he gets no benefit from the excess. He gets no benefit from a casualty loss if he has no tax liability. Twelve million non-taxable income tax returns were filed for 1969 which showed a combined adjusted gross income of $15.4 billion. Deductions and exemptions on these returns totalled $25.7 billion. Those individuals had $10.3 billion in tax benefits coming which were purely hypothetical -- not worth a cent. Does this mean that deductions and exemptions as such are unfair or discriminatory?

Some have suggested the authorization of a negative income tax under which the Internal Revenue Service would send refund checks to individuals for unused deductions, exemptions, etc. But this has never been seriously considered by Congress.

It has been proposed that if a tax credit for tuitions were to be enacted, taxpayers who have not enough tax liability to make full use of the credit should be paid their credit claims by the Internal Revenue Service.

Otherwise, it is held, tax credits for tuitions will benefit only persons in the middle and high income brackets but penalize those with a low income. The authorization

of tuition tax credits would lead to higher tuitions which poor families would have to pay without a possibility of an offsetting benefit.

This problem seems unreal and contrived. It has always been the practice in schools to reduce or waive tuition for some students who are otherwise qualified and meritorious but cannot afford to pay the full tuition. Especially in parochial schools, tuitions are reduced or waived for students from low-income families with many children. If after the authorization of a tuition tax credit tuitions are generally raised and the schools' income substantially increases, those schools will be more able to forego tuitions, wholly or partially, from students whose families lack sufficient tax liability to take full advantage of a tax credit.

If concern persists that higher tuitions might make it more difficult for children from low-income homes to attend private schools -- because their parents could not apply the credits in the absence of an income tax liability -- safeguards could be applied. For example, the law could specify that tuitions are eligible for tax credits only at a school which agrees to reduce or waive tuitions to students who cannot use a tax credit but are otherwise qualified,with an upper limit of, say, 10% of their student enrollment.

I do not believe that such a provision is necessary or advisable, but it could be considered.

To authorize payment by the IRS of tuition tax credits which exceed an individual's tax liability could jeopardize the systems of tax credits as such, as Professor Freund pointed out in his paper to this commission. This would involve the payment to parents of public funds which would then be transmitted to a school. If that school is church-connected, a constitutional question could arise under the Supreme Court decisions from Everson to Lemon. This is equally true of a system that would give parents study grants or vouchers -- which would then be redeemed by the recipient schools. We should be wary of any plan that would channel public funds to a church-connected school, whether directly or through such intermediaries as the students' parents. Only a reduction in otherwise payable taxes appears to be safe from constitutional challenge.

3. "The federal income tax is riddled with special provisions to provide incentives or subsidies for the solution of social problems or benefits to special interests.

This is 'backdoor spending' to hide the true cost from the public and exempt such 'tax expenditures' from the annual appropriation review by the Congress. Many of those special provisions should be discontinued and, if their objective is meritorious, replaced by expenditure programs. No new or additional exclusions, deductions, exemptions or credits for such purposes should be authorized."

The most articulate and persistent opponent of tax incentives is Stanley S. Surrey of the Harvard Law School who served as Assistant Secretary of the Treasury for Tax Policy between 1961 and 1968. He has written extensively on the subject, most recently in two articles in the Harvard Law Review, 1970, "Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures" and "Federal Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance."

Congress prefers to accomplish certain objectives through tax concessions rather than expenditures, for a variety of reasons. The most important among them is that direct appropriations, as a rule, mean stricter and more detailed governmental control through an expanded bureaucracy while tax credits or deductions usually grant greater discretion and freedom of choice to individuals, providing incentives for private initiative to act rather than for government to take over. On the other hand, appropriations often achieve the desired purposes more directly, more precisely, and possibly more quickly.

Many or most of the deductions for educational, scientific and charitable purposes could be replaced by appropriations for the benefited institutions, and this could greatly strengthen governmental influence on their policies. But it could not be done in the case of religious institutions, including church-connected schools. The Constitution, as interpreted by the Supreme Court, forbids it. Therefore, if diversity is to be maintained and if education in nonpublic schools is to be prevented from diminishing and gradually passing from the scene, aid must be provided in indirect form, by tax benefits to parents and donors. It cannot be done through appropriations to church-related schools.

4. "The income tax law has become cluttered with hundreds of special provisions which make it extremely complicated, hard to understand and open to abuse. We should try to simplify the Internal Revenue Code, not add to its intricacies."

This is a good point. The tax law could be made quite simple by abandoning all special provisions and rate scales and subjecting all personal income to taxation. If this were done, a flat rate of 10% could yield about as much revenue as the present 14% to 70% rate scale with hundreds of differentials. But ... would this be fairer? Is such a step politically possible? The answer must, realistically, be in the negative. As long as the tax law cannot be made simple, each newly proposed deviation from the general rule must of course be closely scrutinized to ascertain whether its intrinsic merits equal or exceed those of existing provisions. If they do, then a case for granting it can be made.

5. "The federal budget has been growing apace and is now running an annual deficit of more than $30 billion. This is not the time to reduce federal revenues by granting special tax concessions."

Quite true. But the budget situation did not keep Congress from passing a $15.8 billion tax cut on December 9, 1971, nor from substantially boosting appropriations besides authorizing several big new or expanded spending programs. Decisions on those programs -- and on proposed tax benefits in education -- should be made by relative urgency and priority. If it is deemed important enough to keep nonpublic schools alive so as to enable parents to exercise a choice in education, and to provide children attending nonpublic schools at least a small fraction of the benefits accorded to public school children, adoption of some form of tax benefits for them may be justified.

Moreover, all of those children will be attending schools in any case. They will either enroll at private schools at little cost to the taxpayer; or they will be in public schools at a tax cost several times as high. In this case, as so often, a negative answer may be penny-wise and pound-foolish.

A Tax Credit Plan

1. Credits instead of Deductions for Donations.

Our present method of permitting charitable gifts to be deducted from adjusted gross income has not proven a sufficiently strong incentive to most taxpayers, particularly those at low and middle income levels. To be sure, 32 million taxpayers itemized deductions in 1968 -- out of a total of 73 million individual tax returns -- of whom 30 million listed contributions. But the amount they donated equalled only 3.0% of their adjusted gross income although the law allowed a maximum of 30%, which has since been raised to 50%. If related to the adjusted gross income on all individual tax returns, itemized contributions amounted to only 2.0% of the total. They were heavily concentrated in the top income brackets.

Table V

CONTRIBUTIONS ON TAXABLE RETURNS WITH ITEMIZED DEDUCTIONS AS A PERCENTAGE OF ADJUSTED GROSS INCOME ON ALL TAXABLE RETURNS, 1968

Adjusted Gross Income Class	Adjusted Gross Income	Contributions	Percent
	---------millions --------		
Under $4,000	$ 36,268	$ 317	.87%
$4,000 to under $10,000	192,021	2,924	1.52
$10,000 to under $20,000	206,253	3,988	1.93
$20,000 to under $50,000	67,117	1,691	2.52
$50,000 to under $100,000	19,922	659	3.31
$100,000 to under $200,000	8,272	408	4.93
$200,000 to under $500,000	4,426	316	7.14
$500,000 to under $1,000,000	1,744	152	8.74
$1,000,000 and over	2,273	213	9.37
Total	$538,296	$10,668	1.98%

Source: Statistics of Income: Individual Income Tax Returns, 1968, Internal Revenue Service, 1970. This information was not tabulated for 1969 by IRS.

Table V somewhat understates the total of charitable contributions because the amount donated by persons using the standard deduction is of course unknown. Because standard deductions are used more widely in lower income brackets, Table V overstates the difference in contribution rates between persons with high incomes and low incomes. But it is very substantial in any case, and for good reasons: the deduction method offers a disincentive to taxpayers at low and middle income levels.

The disadvantage of a system under which a man in the top income bracket is reimbursed $70 for every $100 he donates, a man in the lowest taxable bracket only $14, was pointed out earlier and is obvious.

But to grant a 100% credit, as has sometimes been suggested, arouses strong objections which have much merit. I would propose to extend the privilege which taxpayers in the top bracket -- $100,000 for singles, $180,000 for heads of household, $200,000 for married couples filing joint returns -- now enjoy, of offsetting 70% of their gifts, to all taxpayers, regardless of the size of their income.

This privilege could be granted for gifts to educational institutions only, because they are under the most severe financial pressure and in a state of crisis. Extensions to hospitals and other charitable organizations might be considered at some future time. That would of course increase the cost -- but it could be a lifesaver that would make vast subsidies and an eventual government takeover unnecessary.

2. Tax Credits for Tuitions.

Donations to schools are presently tax deductible, tuitions are not, because the payer receives something in return, the right to school attendance. He could of course obtain that right for free, at a public school. He pays for exercising his right of free choice. Still, since the basic service is available without charge, school tuition contains some element of a donation.

As a practical matter, few parochial or other religious schools, if any, obtain their entire support, or even the major part of it, from tuitions. Most parents could not afford to pay the full cost of their children's education at a private school -- after paying taxes for the public schools. We may estimate that, in the national average, at least two-thirds, and possibly up to three-fourths, of denominational elementary school expenses are footed by the sponsoring churches, and slightly less in the case of secondary schools. This means that a substantial part of the sources of private school revenues already enjoys tax deductibility -- in a roundabout way. This is also true of the tuitions that show up as "child care" expenses on tax returns.

This could be greatly simplified by giving material recognition for tax purposes to tuitions. The deduction method would be even less advisable for tuitions than it is

for donations. Tax credits are the only effective way of making tuition tax benefits meaningful.

Tax credit proposals for tuitions in elementary and secondary schools usually suggest a 100% credit with a dollar ceiling. Some years ago I proposed to the education committees of the House and the Senate a 100% credit for tuitions up to $100, or a 50% credit for tuitions up to $200.[1] I now believe that a percentage formula ought to have a floor as well as a ceiling.

The purpose of a tuition tax credit is to assist children attending schools of their own or their parents' choice by helping them to defray the concomitant expenses. An assignment of this commission, under its Presidential mandate, is a particular concern with the financial problems of the nonpublic schools, the prime objective being to give them a better chance of survival. Aid to children attending nonpublic schools would accomplish nothing if such schools were not operative and available where they are needed. In fact, the parents' right to freely choose a school, affirmed in the Pierce case, would be a mockery, if public schools attained a monopoly position by the closing of most private schools. Since much of the problem is financial, thought must be given to means of increasing nonpublic school revenues by aiding their supporters. School income can be substantially raised by boosting tuitions -- if care is taken not to place a commensurate burden on the families paying them. That is the purpose of the tax credit, rather than to offer relief from their current burden to parents of nonpublic school children.

School revenues can be more effectively increased for a given amount of federal assistance by offering a credit of 70% rather than of 100% of the tuitions. A $100 tuition boost would then yield the school $100 but it would reduce federal revenues by only $70, the amount of the parents' tax credit. Moreover, there is a certain appeal in using the present top rate of the income tax.

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[1] Aid to Elementary and Secondary Education, Hearings before the General Subcommittee on Education, Committee on Education and Labor, House, 1965, p. 1390. Elementary and Secondary Education Act of 1965, Hearings before the Subcommittee on Education, Committee on Labor and Public Welfare, Senate, 1965, p. 2774.

There must of course be a reasonable ceiling, to protect the federal treasury and to prevent some schools from boosting their tuitions to excessive heights at governmental expense.

Current expenditures per pupil in average daily attendance -- not counting capital outlays -- in public schools averaged $839 in the school year 1970/71 and may be in the neighborhood of $950 in 1972/73. The credit ceiling for private school parents would have to be substantially lower, possibly 20% to 25% of public school costs for elementary education, 25% to 35% for secondary schools. It could, for example, be $200 for children attending elementary schools (up to grade 6 or 8) and $400 for those in high schools. The plan would yield the schools much larger revenues if a floor of $100 were established. This means a 70% tax credit for tuitions between $100 and $300 in elementary education, between $100 and $500 in secondary education.

Table VI

PROPOSED TAX CREDIT SCHEDULE

Elementary Education			Secondary Education		
Tuition	Credit	Net Tuition (after credit)	Tuition	Credit	Net Tuition (after credit)
$100	$ 0	$100	$100	$ 0	$100
200	70	130	200	70	130
300	140	160	300	140	160
400	140	260	400	210	190
			500	280	220
			600	280	320

Considering the fact that at least 10% of the children would pay no tuitions and claim no credit, the annual cost to the federal treasury would be in the neighborhood of $900 million. That equals less than one-fourth of the cost that would be added to the tax bill if those children were attending public schools.

The cost of the tax credit will decline if enrollment in nonpublic schools continues to shrink at anything near the rate it has fallen over the past five years. The credit will cost more if nonpublic enrollment turns upward again -- at a substantial saving to the taxpayers supporting public schools. The credit should be granted for all tuitions, that is, regular charges for school attendance. It could be, but I do not believe that it should be, extended to books or similar ancillary expenses.

A tax credit would involve no entanglement between the state and the schools and be relatively simply to administer. Each school would issue a printed tuition receipt in several copies (similar to form W-2), one of which would have to be attached to form 1040, the income tax return.

Some observers are uneasy about tuition tax credits because high income families might derive benefits from them. That may be a good political argument but has otherwise little standing. Wealthy persons get social security payments and Medicare, can send their children to public schools free of charge and participate in dozens of other governmental benefits which, as a matter of right, are available to all Americans on an equal basis. Deductions for state and local taxes, donations, etc. are in fact heavily concentrated in the high income brackets.

It is conceivable though that a tuition tax credit program would engender more popular appeal if it were limited to persons in the low and middle income brackets and this can easily be done. To set an income ceiling, however, would create a "notch" problem.

That is why under the tuition tax credit plan in higher education which was passed by the Senate on several occasions the credit is reduced by 1% of the amount by which the taxpayer's income exceeds $25,000. The credit disappears completely, in the case of the higher education plan, at an income of $57,500. Under the schedule above it would disappear in the case of elementary pupils at $39,000; in the case of high school pupils at $53,000.

Considering the fact that the median family income in 1972 will run at about $11,000 (mean family income around $12,000) and that one-fourth of all families will enjoy an income of $15,000 or more, a gradual reduction from a $25,000 level on may offer a reasonable compromise.

Concern has been expressed that some nonpublic schools, whose tuitions are eligible for tax credits, may follow discriminatory admission policies. While public schools must accept all local children of the proper age, private schools establish their own entry rules. Church-connected schools tend to prefer members of their own denomination and their right to do so should be preserved.

Many nonpublic schools aim to maintain high academic standards and therefore admit only students who can demonstrate on standard tests or from past records that they are capable of pursuing a rigorous curriculum. Again, preservation of this right is essential.

To prevent racial discrimination, rules could provide that schools which participate in the tax credit plan may not refuse admission to otherwise qualified students because of race, color or ethnic origin nor have to accept students for such reasons.

While this paper discussed educational tax credits mainly in terms of the federal tax system, it is obvious that they can also be used in state taxation. Minnesota was the first state to establish in 1971 a system of tax credits against its income tax for tuitions paid to nonpublic schools.

In conclusion, I should mention that income tax credits can also be used to aid in the financing of public schools. At hearings of the House and Senate Education Committees in 1965 I suggested the granting of income tax credits for residential school property taxes.[1] This would enable the public schools to finance themselves more adequately at the local level without placing a commensurate direct burden on local taxpayers.

The homeowner's property tax is widely felt to be the most burdensome tax. It usually is the only, or at least the largest, tax which most wage earners actually pay over to government. Most other taxes are collected by withholding, by small additions to the price of goods bought, or by including them in the price of those goods and services.

The property tax has in the long run actually risen less than most other taxes -- it increased from 4.0% of the national income around 1900 to 4.3% in 1970, while the aggregate of all other taxes simultaneously jumped from 3.8% of the national income to 25.3%. The value of residential real estate has, in the long run, grown faster than property taxes, as appears from a new study by the Bureau of Business Economics in

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[1] Aid to Elementary and Secondary Education, Hearings before the General Subcommittee on Education, Committee on Education and Labor, House, 1965, p. 1390. Elementary and Secondary Education Act of 1965, Hearings before the Subcommittee on Education, Committee on Labor and Public Welfare, Senate, 1965, p. 2774.

the Department of Commerce. Moreover, only about one-fourth of all property tax collections comes from homeowners. But because of its method of collection, and for other reasons, many of them view the property tax as the most obnoxious tax. The national government could provide effective relief to homeowners while aiding the public schools financially without interfering with local school control, by the authorization of income tax credits for residential school property taxes.[1]

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[1]The U. S. Senate approved on November 20, 1971, with a 65:19 vote, a 100% property tax credit -- up to $300 of the tax or 25% of rental paid -- for persons 65 years or older with an adjusted gross income up to $6500, with some advantages up to $6800. The credit I am proposing would not be limited by age and the income ceiling would have to be much higher. But it would not need to be a 100% credit.

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